

Audit Report

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**Comptroller of Maryland  
Motor-fuel, Alcohol and Tobacco Tax Division**

July 2010

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**OFFICE OF LEGISLATIVE AUDITS**  
DEPARTMENT OF LEGISLATIVE SERVICES  
MARYLAND GENERAL ASSEMBLY

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**Karl S. Aro**  
Executive Director

**DEPARTMENT OF LEGISLATIVE SERVICES**  
**OFFICE OF LEGISLATIVE AUDITS**  
**MARYLAND GENERAL ASSEMBLY**

**Bruce A. Myers, CPA**  
Legislative Auditor

July 28, 2010

Senator Verna L. Jones, Co-Chair, Joint Audit Committee  
Delegate Steven J. DeBoy Sr., Co-Chair, Joint Audit Committee  
Members of Joint Audit Committee  
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Motor-fuel, Alcohol and Tobacco Tax Division (MATT) of the Comptroller of Maryland for the period beginning July 1, 2007 and ending June 30, 2009. MATT administers laws and regulations pertaining to the manufacture, storage, transportation, sale, and distribution of alcoholic beverages, tobacco, and motor fuel, and collects the related excise taxes. Effective July 1, 2009, MATT discontinued functioning as a separate division and became a unit within the Comptroller's Revenue Administration Division.

Our audit disclosed that MATT's controls over alcohol and tobacco tax receipts and tobacco tax stamps need improvement. Specifically, procedures for the verification of alcohol and tobacco tax receipts and for the destruction and inventory of returned tobacco tax stamps were inadequate.

The Comptroller of Maryland's response to this audit, on behalf of MATT, is included as an appendix to this report. We wish to acknowledge the cooperation extended to us by MATT during the course of this audit.

Respectfully submitted,

Bruce A. Myers, CPA  
Legislative Auditor



## Background Information

### Agency Responsibilities

The Motor-fuel, Alcohol and Tobacco Tax Division (MATT) administers laws and regulations pertaining to the manufacture, storage, transportation, sale, and distribution of alcoholic beverages, tobacco, and motor fuel, and collects the related excise taxes. MATT's primary responsibilities consist of reviewing alcohol, tobacco, and motor carrier tax returns and refund requests, and performing certain licensing functions. Although MATT is responsible for the identification, collection, and deposit of alcohol and tobacco tax receipts and motor fuel tax receipts, during our audit period, the subsequent accounting for these funds (including distribution to appropriate State Funds and programs in accordance with statutory requirements) was the responsibility of the Revenue Administration Division (RAD). According to MATT's records, its alcohol and tobacco tax and motor fuel tax collections and related distributions for fiscal year 2009 were as follows:

Table 1 Taxes and Related Fees Collected and Distributed – Fiscal Year 2009		
	Type of Tax	
	Alcohol and Tobacco Tax	Motor Fuel Tax
	(dollars stated in millions)	
<b>Gross taxes and related fees collected</b>	\$434.3	\$758.0
Less:		
Refunds	0	21.9
Administrative expenses	0	7.9
Total refunds and expenses	0	29.8
Balance available for distribution	\$434.3	\$728.2
Distribution of remaining balance: ❶		
To State's General Fund	\$434.3	\$6.5
To Transportation Trust Fund	0	715.3
To Chesapeake Bay Trust Fund	0	6.4
Total distributions	\$434.3	\$728.2

❶ The Revenue Administration Division was responsible for distributing these collections.

## Organizational Change

Effective October 1, 2005, certain duties and responsibilities within the Comptroller of Maryland were reorganized. Specifically, the Motor Fuel Tax Division was merged into the Regulatory and Enforcement Division (RED). RED was responsible, for example, for collecting excise taxes on alcoholic beverages and tobacco, reviewing motor carrier tax returns and refund requests, and performing certain licensing functions. Subsequently, the Comptroller of Maryland reorganized RED into two separate divisions effective July 1, 2007. Specifically, certain responsibilities were transferred from RED to create the Motor-fuel, Alcohol and Tobacco Tax Division (MATT).

Effective July 1, 2009, certain duties and responsibilities within the Comptroller of Maryland were again reorganized. Specifically, MATT discontinued functioning as a separate division and became a unit under the Revenue Administration Division (RAD). For the period from July 1, 2007 to June 30, 2009, MATT existed as a separate division of the Comptroller of Maryland, and the scope of our audit included the activities of MATT during this period. Our findings and recommendations related to this audit were addressed by RAD. In the future, the duties and responsibilities of the former MATT will be audited during our audits of RAD.

## Findings and Recommendations

### Cash Receipts

#### **Finding 1**

**Controls over verifying that alcohol and tobacco tax receipts were deposited were insufficient.**

#### **Analysis**

Controls over verifying the deposit of alcohol and tobacco tax receipts (in the form of checks received in the mail), which totaled approximately \$46.4 million during fiscal year 2009, were not sufficient. Specifically, the initial recordation documents, along with the related cash receipts, were forwarded to two employees who were responsible for preparing the bank deposits and for updating taxpayer accounts receivable records. Furthermore, the initial recordation documents were then given to a third employee who was responsible for verifying them to the validated deposit slips. However, because the initial recordation documents were not forwarded directly to the employee who performed the

deposit verifications, collections could be misappropriated without immediate detection. The Comptroller of Maryland's *Accounting Procedures Manual* requires that an employee independent of the collections function ensure that all collections were subsequently deposited, and that the cash receipts and accounts receivable responsibilities be separated.

#### **Recommendation 1**

##### **We recommend that**

- a. the employee(s) who prepares the initial recordation documents forward those documents directly to the independent employee who performs the deposit verifications, and that these documents be used in the verification process; and**
- b. employees with access to collections not have access to the related accounts receivable records.**

**We advised RAD on accomplishing the necessary separation of duties using existing personnel.**

## **Tobacco Tax Stamps**

#### **Finding 2**

**Controls over the destruction and inventory of returned unused tobacco tax stamps were inadequate.**

#### **Analysis**

The controls over the destruction and inventory of returned unused tobacco tax stamps were not adequate. Excise tax stamps are sold to tobacco product wholesalers who affix the stamps to each product (for example, to each pack of cigarettes) to show that the Maryland tobacco taxes have been paid. The selling price of the stamps reflects the current tax rate. For example, the current tax rate is \$2.00 for a pack of 20 cigarettes. Wholesalers return unused stamps to MATT, for eventual destruction, because they are mutilated, or for other reasons, and receive credit for future purchases. Our review disclosed the following conditions:

- Although MATT performed a verified count of returned tobacco stamps when they were received, the stamps were not immediately destroyed; according to MATT's records, stamps returned during fiscal year 2009 were, on average, destroyed approximately one month after receipt. In addition, the stamps were not re-counted, prior to destruction, by the three employees that witnessed the destruction of the stamps. Furthermore, while the returned

stamps were stored in a secured cabinet to await destruction, one of the aforementioned three employees also had routine access to the secured cabinet for inventory purposes.

- MATT did not maintain an accurate record of tobacco tax stamps that had been returned from wholesalers. On March 31, 2010, we conducted an inventory of the returned stamps awaiting destruction and determined there were 34,127 stamps, with a face value of \$68,254, that had not been recorded on the returned stamp inventory log. According to that log, only 18,029 stamps were awaiting destruction; these stamps had been received between November 2, 2009 and March 12, 2010.

As a result of these conditions, there was a lack of assurance that all stamps returned for destruction were actually destroyed. Stamps that are usable could be misappropriated and reissued without detection. According to MATT's records, 333,506 returned stamps, with a face value of approximately \$667,012, were destroyed in fiscal year 2009.

## **Recommendation 2**

**We recommend that RAD**

- a. either perform an immediate destruction of returned tobacco tax stamps once initially verified or re-verify the count prior to subsequent destruction,**
- b. ensure that individuals responsible for witnessing the destructions of stamps are independent of the inventory functions for the stamps, and**
- c. ensure that all returned stamps are inventoried and properly accounted for.**

## **Audit Scope, Objectives, and Methodology**

We have audited the Comptroller of Maryland – Motor-fuel, Alcohol and Tobacco Tax Division (MATT) for the period beginning July 1, 2007 and ending June 30, 2009. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine the MATT's financial transactions, records and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit included cash receipts (primarily for taxes and fees collected for motor fuel, alcohol, and tobacco transactions) and accounts receivable. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of the MATT's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

Our audit did not include certain support services provided to MATT by the Comptroller of Maryland – Office of the Comptroller. These support services (such as processing of invoices, maintenance of accounting records, and related fiscal functions) are included in the scope of our audits of the Office of the Comptroller. Our audit also did not include certain support services provided to MATT by the Comptroller of Maryland – Information Technology Division related to the procurement and monitoring of information technology equipment and services. These support services are included in the scope of our audits of the Information Technology Division.

MATT's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

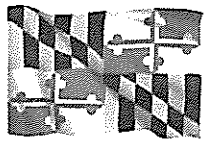
Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect MATT's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our audit did not disclose any significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to MATT that did not warrant inclusion in this report.

The Comptroller of Maryland's response, on behalf of MATT, to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise the Comptroller of Maryland regarding the results of our review of its response.

APPENDIX



COMPTROLLER  
*of* MARYLAND  
*Serving the People*

Peter Franchot  
*Comptroller*

Linda L. Tanton  
*Deputy Comptroller*

July 27, 2010

Bruce A. Myers, CPA, Legislative Auditor  
301 West Preston Street, Room 1202  
Baltimore, MD 21201

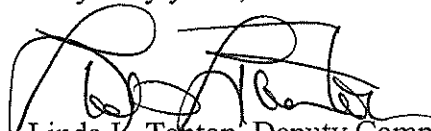
Dear Mr. Myers:

Thank you for the opportunity to respond to your audit report on the Comptroller of Maryland – Motor-fuel, Alcohol and Tobacco Tax for the period beginning July 1, 2007 and ending June 30, 2009.

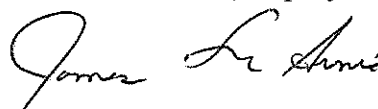
Enclosed are our responses to the recommendations contained in the audit report. We thank you and your staff for providing suggestions and recommendations, both of which have already been implemented, that will enable the Division to improve fiscal operations and strengthen internal controls.

If you desire any additional information, we will be happy to respond to your request.

Very truly yours,



Linda L. Tanton, Deputy Comptroller



James M. Arnie, Director  
Revenue Administration Division

LLT/bob

Enclosure

cc: The Honorable Peter Franchot

## **Responses to Findings and Recommendations**

### **Cash Receipts**

#### **Recommendation 1**

**We recommend that**

- a. the employee(s) who prepares the initial recordation documents forward those documents directly to the independent employee who performs the deposit verifications, and that these documents be used in the verification process; and**
- b. employees with access to collections not have access to the related accounts receivable records.**

**Division Response:** *During the audit period, the Division was working out a reorganization plan to fully integrate the functions related to processing motor fuel, alcohol and tobacco tax (Matt) returns and accounting for the revenue from these tax types into the existing organizational structure. Since then, we have fully implemented the reorganization, and in so doing, we have addressed the issues raised by the auditors. Division procedures for the handling of cash receipts, which were recently enhanced in response to a legislative audit recommendation, have been applied to these tax types as well.*

### **Tobacco Tax Stamps**

#### **Recommendation 2**

**We recommend that RAD**

- a. either perform an immediate destruction of returned tobacco tax stamps once initially verified or re-verify the count prior to subsequent destruction,**
- b. ensure that individuals responsible for witnessing the destructions of stamps are independent of the inventory functions for the stamps, and**
- c. ensure that all returned stamps are inventoried and properly accounted for.**

**Division Response:** *As part of the reorganization, responsibility for the inventory and destruction of tobacco stamps was moved to the appropriate section, which is generally responsible for inventory functions. In addition, we have written and implemented procedures for the accountability of tobacco stamps that are consistent with the audit recommendation.*

AUDIT TEAM

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